

What role does cost-benefit analysis really play in policymaking?

Politics and Regulatory Policy Analysis

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The question of what role cost-benefit analysis (CBA) should play in regulatory decision-making is now over 35 years old. Proponents laud its potential to bring rationality to government decision-making. Opponents argue that it is inherently biased against government intervention in the market because it insufficiently measures benefits as a result of discounting and the difficulty associated with monetizing lives saved by regulations.

While the normative debate over CBA is well-worn ground, the positive debate over the role it has actually played is often ignored or ill-informed. Opponents often bemoan the influence of economic analysis, citing the correlation between lower levels of regulation in Republican administrations that typically support CBA. Meanwhile, supporters see the continuing federal output of regulations that would not pass a cost-benefit test and conclude that CBA, as it is currently implemented, is not working.

This positive debate is particularly important because its resolution bears on discussions over reforms to the regulatory process. Before strengthening or weakening CBA requirements, it would behoove would-be reformers to understand how CBA currently works and why.

In the Fall 2003 issue of *Regulation*, Bob Hahn and Erin Layburn squared off against William Niskanen in a discussion of reforming the regulatory process. Hahn and Layburn recommend expanded reporting from regulatory agencies and the

creation of a congressional office of regulatory analysis. As grounds for doing so, they contend that the current requirements for regulatory impact analyses are too weak to make a difference in regulatory policy. The office in charge of reviewing these analyses, the Office of Information and Regulatory Affairs (OIRA), "has shown that its political constraints are too great to allow enough flexibility to critique agencies' analysis." Niskanen is skeptical about the solutions proposed by Hahn and Layburn, claiming that their proposals would merely "produce more lonely numbers" that policymakers would ignore. Implicit in Niskanen's argument is the claim that OIRA's political constraints would also constrain any reform proposal that attempts to strengthen requirements for CBA.

Many of the scholarly and political debates about CBA focus on the merits or problems of the technique itself. The articles by Hahn and Layburn and by Niskanen, however, touch upon central but relatively unexamined questions: What role has cost-benefit analysis already had, and how have the institutional constraints surrounding it affected the regulatory process? This article suggests answers to those questions and assesses the Hahn/Layburn proposals accordingly.

CBA'S IMPACT

The debate over CBA is more than two decades old and shows no sign of abating. With every increase in the number or complexity of the analytical requirements imposed on agencies promulgating regulations, supporters of economic analysis voice their hopes that regulation will become more cost effective, while opponents argue that the regulatory process will suffer greatly or that agencies will abandon rulemaking altogether.

Despite the stridency of the disagreement, there is little empirical evidence to support either position. Rulemaking has

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not been abandoned in the wake of OIRA's creation, nor have the net benefits of regulations measurably increased. Neither the promoters nor the critics of CBA have seen their predictions realized. Weighing against the claim that analysis requirements have stifled regulatory movement are the facts that agencies have continued to regulate throughout the period during which CBA requirements have been in place, the cost of regulations has continued to run as high as \$800 billion annually, and there is little evidence that the time to produce a rule has increased.

While there is little evidence that CBA requirements have deterred rulemaking, this leaves unanswered the question of whether cost-benefit analysis has resulted in regulations with greater net benefits. No conclusive study exists comparing the net benefits of regulations promulgated before Executive Order No. 12291 (President Ronald Reagan's executive order giving OIRA authority to review regulations and requiring cost-benefit analysis on some regulations) and those promulgated in the 25 years since. However, a number of economists have reviewed recent rules and have largely concluded that the hopes of analysis proponents have not come to fruition. For example, Kip Viscusi and Ted Gayer concluded in a Fall 2002 *Regulation* article, "Health and safety regulations have fallen short of any reasonable measure of performance." Further, every edition of the federal report on the costs and benefits of regulations shows that numerous rules have higher costs than benefits.

Further evidence that CBA requirements have had little effect is the constant attempts to strengthen them. These include the passage of actual laws, including the Unfunded Mandates Reform Act and the Congressional Review Act; and the proposal of many other bills. Proponents have justified these changes, proposed and enacted, largely in order to reduce the costs of federal regulations, thereby implying that the current requirements still result in regulations whose benefits do not justify their costs. Unfortunately—from the perspective of those proponents—the supplemental requirements that have been enacted appear to have done little to change the situation. This leads to the question of why economic analysis requirements have neither stopped the regulatory process cold nor led to more economically efficient regulations.

EXECUTIVE REVIEW

As noted above, OIRA has responsibility both for ensuring that agencies base their regulatory decisions on impact analyses and for exercising control over those agencies on behalf of the pres-



ident. Both of those missions have had a controversial history. The discussion of the role of the president in overseeing regulatory decision-making has taken place largely within the legal community and compares presidential control with alternatives like congressional control, interest-group control, and bureaucratic discretion.

A number of prominent authors have praised the concept of presidential control of agency regulatory activity. Elena Kagan, in a prominent 2001 *Harvard Law Review* article, cited the Clinton administration's use of executive review in arguing that the president is uniquely positioned to enhance both the accountability and the efficiency of administrative decisions. Others support

executive review on the grounds that it yields better management of executive agencies and implementation of a uniform regulatory policy; that it encourages policy coordination, political accountability, and more balanced decision-making; and that the president is more likely to advance national over factional interests. In the late 1980s, the Administrative Conference of the United States and the American Bar Association endorsed executive oversight of the regulatory process.

By contrast, Reagan-era critics contended that executive review gave unelected bureaucrats unwarranted authority over Cabinet officials who were supposed to be responsible to Congress. With President Bill Clinton's adoption of Executive Order No. 12866 that endorsed executive oversight of the regulatory process, opposition to executive control over rulemaking has abated. It has not vanished, however. Cynthia Farina, in a 1998 *Harvard Journal of Law and Public Policy* article, assailed the new advocacy of presidential power over the regulatory regime as inherently anti-regulatory and as increasing the likelihood that the regulatory system will collapse under its own weight.

Regardless of scholars' positions on whether increased presidential oversight of the regulatory process is a positive or a negative development, there is widespread agreement that with Executive Orders 12291 and 12866, the role of the president in the regulatory process has been permanently increased. Now that both Republican and Democratic administrations have affirmed the role of OIRA in exercising control over agencies, its place seems secure: future presidents are likely to continue to use OIRA to impose their agendas on regulatory agencies. As James Blumstein notes in a 2001 *Duke Law Journal* article, "From controversial to mainstream in twenty years, centralized presidential regulatory review has now taken center stage as an institutionalized part of the modern American presidency."

Are the two missions of OIRA—reviewing the analytical bases for agencies’ regulatory activity and furthering presidential agendas—compatible? Many of the articles I have mentioned deal explicitly with only one of the missions and pay only glancing attention to the other. Christopher DeMuth and Douglas Ginsburg, writing during the early years of OIRA, call the two complementary. Richard Pildes and Cass Sunstein also note some level of compatibility between the technocratic goals of cost-benefit analysis and the democratic goals of presidential review; they suggest ways to make them more compatible.

Thomas McGarity addresses this question extensively in his 1993 book *Reinventing Rationality*, which examines the role of economic analysis in the federal government. With several chapters devoted to Office of Management and Budget review under the Reagan and George H. W. Bush administrations, McGarity discusses the perception that analysis was merely a cover for anti-regulatory policy preferences. Since the publication of McGarity’s work, OIRA’s executive review and analysis functions have interacted through two additional administrations, increasing our ability to evaluate their relationship. More recently, William West argues in *Presidential Studies Quarterly* that regulatory review has indeed been quite responsive to presidential preferences and that this responsiveness is more characteristic of OIRA than neutral competence.

CBA AND POLITICS Scholarship considering OIRA’s dual goals is the exception, however. The literature on OIRA’s two missions has largely focused on one or the other, generally ignoring their interaction. To simplify the question of how executive review affects cost-benefit analysis, consider four

basic scenarios, outlined in Table 1. The two missions of OIRA will converge on common goals when the existing administration supports a regulation with positive net benefits (Box A) or opposes one with negative net benefits (Box D). To appreciate the effect of the interaction between cost-benefit analysis and executive review on the regulatory process, one must examine cases in which the two goals are in tension: i.e., where there is administration support for regulations (or regulatory alternatives) whose costs outweigh their benefits (Box C) or where there is administration opposition to regulations supported by cost-benefit analysis (Box B).

Locating actual examples of “Box B” scenarios is difficult. If analysis prevails and a regulation is issued, the administration will nearly always claim after-the-fact that it supported the regulation all along. By contrast, if the administration’s political preference prevails over analysis, the only evidence will be that a particular rule was not promulgated, something that is very difficult to detect. The best examples of Box B cases come from Reagan administration interviews cited by Erik Olson showing that analysis took a backseat to political preferences of the executive under Reagan:

As one key OMB official notes, “debate on the merits of the economic analysis doesn’t help resolve the real issues where OMB has budgetary, philosophical, or political problems with a rule; the regulatory analysis is used as a ‘key’ in holding up or changing the EPA action.”

This shows that, for the Reagan administration at least, when analysis supported a regulation and the administration opposed it, economic analysis was a secondary concern in the review process and the regulation was not promulgated. McGarity provides additional examples, presenting several cases in which political preferences trumped analysis. In his discussion of the Environmental Protection Agency’s National Ambient Air Quality Standards, McGarity cites an internal Reagan administration dispute in which additional analysis might have shown that a stricter air quality standard was justified, but in which that analysis was not carried out:

Apparently a conflict erupted in OMB between the purists who were keen on analysis and the ‘realists’ who were keen on analysis so long as it signaled less burdensome regulation but were willing to ignore it when it argued for greater stringency. The realists carried the day.

Examples of regulations fitting in Box C are easier to find. If we assume that the purpose of cost-benefit analysis is to select regulatory alternatives with net social benefits, then numerous rules promulgated over the past 25 years fail this test. One need only examine the economic studies by Hahn and others. While comparable data have not yet been compiled on rules from the current Bush administration, there are many examples of regulations related to homeland security with ill-defined benefits and very high costs. (For examples, see any of the recent OMB reports to Congress on the costs and benefits of federal regulations.) In all of these cases, the most likely conclusion is that

TABLE 1

Politics And Policy Analysis

Intereaction of CBA and executive review

		WHITE HOUSE POSITION	
		Supports Regulation	Opposes Regulation
CBA RESULT	Supports Regulation	(Box A) Regulation Promulgated	(Box B) Regulation Promulgated Only if Analysis Prevails
	Opposes Regulation	(Box C) Regulation Promulgated Only if Politics Prevails	(Box D) Regulation Not Promulgated

the administration supported these rules despite the negative or indeterminate results of the analysis.

It is possible that these examples are exceptions and that, by and large, cost-benefit analysis requirements have led to more efficient and cost-effective regulations. This is unlikely, however. First, if the examples discussed here were exceptional, one would expect to see, during the same time period, a significant number of Box C regulations being returned to agencies for failing to meet cost-benefit requirements. During the eight years of the Clinton administration, however, only 16 rules were returned for agency reconsideration, and it is hard to argue that any of them had significant political support. In the George W. Bush administration, no rule regarding homeland security has been rejected. Even in the George H. W. Bush administration, there were only nine rules returned during his last year in office (compared to 28, 21, and 29 during each of the first three years) when President Bush was running for reelection and presumably concerned about offending constituencies by returning agency regulations.

In addition to the empirical evidence cited above, there is also a theoretical argument supporting the conclusion that executive review generally trumps economic analysis when the two conflict. The very virtues promoted by supporters of executive review may well run counter to the goals of regulatory impact analysis. As discussed above, chief among these virtues are that executive review promotes the accountability of bureaucrats to the popular will and leads to greater efficiency in the regulatory process.

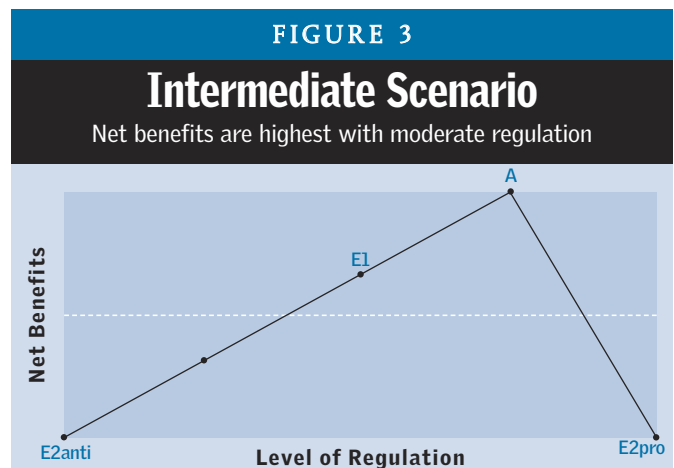
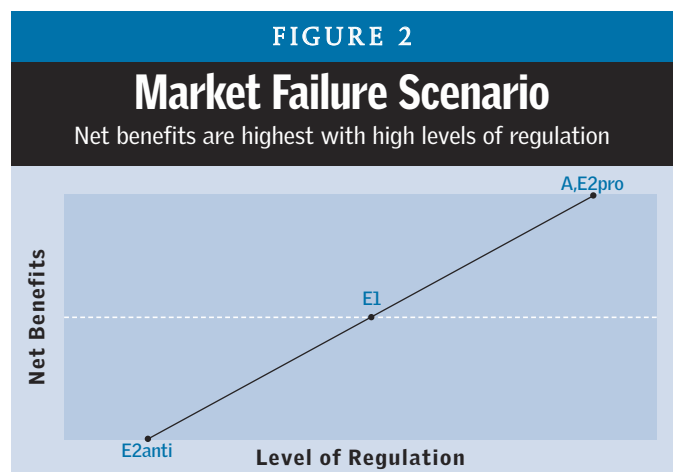
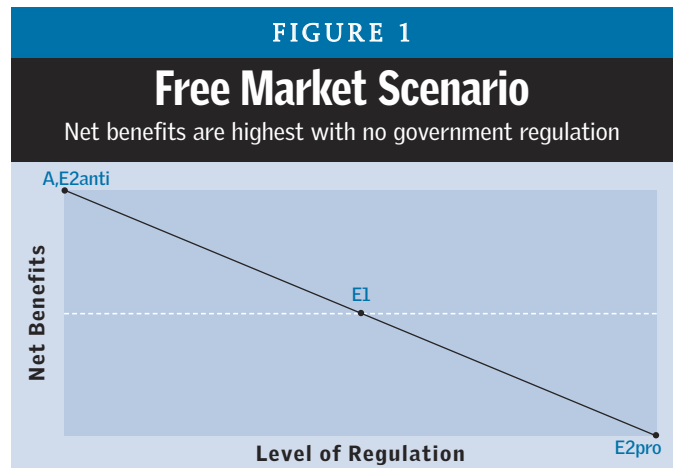
The conflict between promoting bureaucratic and economic efficiency is simple. The requirement of thoughtful and thorough analysis is not intended to make the regulatory process more efficient. Accordingly, many of the critics of analysis complain about “paralysis by analysis” crippling the regulatory process. There is, indeed, little doubt that requiring a thorough analysis to support significant rulemakings adds some time to the regulatory process. It is difficult to believe that the very agency charged with increasing the efficiency of the regulatory process will be able to enforce a requirement that, if done thoroughly, will make the regulatory process slower. As noted above, there is little evidence that it has taken longer to promulgate rules, suggesting that promotion of bureaucratic efficiency has trumped economic efficiency.

POLITICAL ACCOUNTABILITY

What about accountability? The conflict between analysis and accountability is, in theory, even more acute. Below, I develop a simple framework for thinking about the interaction between accountability and regulatory analysis. To presage the results of using this framework, the interaction of the two will depend on the nature of the net benefit curve and on the interests holding the executive accountable in a particular rulemaking effort. In some cases, subordinating analysis requirements to executive review will lead to analytically supported outcomes, while in others it will not. This theoretical model yields results consistent with actual outcomes over the past 25 years.

Envision a two-dimensional graph. On the x-axis is the level of regulation, and on the y-axis are the net benefits of the var-

ious regulatory options. Positive values on the y-axis represent net benefits, and negative values represent net costs. How net benefits will vary with the level of regulation will depend on the economics of the particular issue. I call a scenario in which net benefits would be highest without regulation and would decrease with more regulation the “Free Market Scenario,” which is depicted in Figure 1. I call a scenario in which net benefits would be highest with high levels of regulation and would decrease with less regulation the “Market Failure Scenario,” which is depicted in Figure 2. Finally, I call a scenario in which net benefits would be highest at some point between no regulation and stringent regulation the “Intermediate Scenario,” which is depicted in Figure 3



In a system where all decisions are made according to the results of a perfectly conducted regulatory impact analysis, the regulatory option chosen would be the one for which net benefits are the highest (denoted by point “A” on each graph). We know from the discussion above that this is not currently the case.

In what way does the political accountability embodied in executive review constrain these choices? The literature on executive review suggests several possibilities. Kagan, in her *Harvard Law Review* article, argues that executive review leads to regulatory choices that better reflect the preferences of the electorate. If this is the case, then according to the median voter model, the president and his staff will restrict the regulatory choices to those in the middle of the spectra above. (This assumes that, as in the median voter model, voters are distributed symmetrically on regulatory issues). This may mean that

although a regulatory option with positive net benefits may be chosen, it is unlikely to be the option with the greatest net benefits. Once again, this depends on how much the accountable executive restricts the policy choices.

Critics of executive review argue that the president is less subject to pressure from the electorate than from powerful interest groups. If this is true, we can expect the president’s staff to constrain agency choices toward one end of the spectrum or the other. An administration beholden to anti-regulation groups would constrain choices to the left end of the spectrum, while one that listens primarily to pro-regulation groups would constrain choices to the right end. Once again, the width of the constraint will vary from issue to issue. Points reflecting the policy choices of an executive responsive to interest groups on either end of the political spectrum are indicated with an “E2” on the graphs above. “E2anti” refers to an executive responsive

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choices are constrained to a very narrow range of options where the median voter falls. It could also mean that any option between the 25th and 75th percentile of regulatory activity is acceptable. How wide or narrow this constraint is likely to be will depend on a range of factors such as the salience of the issue, the timing of the regulation, and the intensity of the interest group climate. In the three figures, the points labeled “E1” reflect the policy choices of an executive choosing an option in the absolute middles of the spectrum.

In those scenarios in which either no regulation or stringent regulation produces the highest net benefits, the executive review constraint (denoted by E1) will ensure that the choice with highest net benefits is not selected. Any choice not on either extreme of the spectrum produces less than optimal net benefits. In fact, depending on how narrowly the president and his staff restrict agency choices, and depending upon where the graph crosses the x-axis (the x-axis represents the points at which net benefits are equal to zero), it is possible that the result will be a choice with negative net benefits. In Figure 1 and Figure 2, the point E1 occurs where the net benefits equal zero. (This is for illustrative purposes and need not always be the case, i.e., the net benefit line need not cross the x-axis right at the middle of the political spectrum.)

In the “Intermediate Scenario,” the prospects are somewhat more sanguine. If a level of regulation toward the middle of the spectrum leads to the greatest net benefits, then an executive responsive to the general electorate will encourage agencies to choose options that are analytically supported. It should be noted, however, that the peak representing the greatest net benefits may be more toward one side or the other. In that case,

to anti-regulation groups, and “E2pro” refers to an executive responsive to pro-regulation groups.

Interestingly, the effect of accountability to interest groups will be nearly the opposite of accountability to the general electorate. In Figure 3, analytically sound options were likely to be chosen if the president was accountable to the general electorate. (E1 occurred where there were positive net benefits because the electorate wants a result that is in the middle of the spectrum, which is where the options that have positive net benefits are also found.) By contrast, if the president is accountable to interest groups under this scenario, then options with low or negative net benefits are likely to be chosen. (Both E2 points occur where there are negative net benefits.)

In those cases where net benefits are greatest either with no regulation or stringent regulation, the analytical soundness of the policy chosen will vary with the interest groups to which the administration listens. An administration that is supported by anti-regulation constituent groups will choose regulatory options with high net benefits in the Free Market scenario and negative net benefits in the Market Failure scenario. An administration responsive to pro-regulation groups will choose an option with high net benefits in the Market Failure scenario and negative net benefits in the Free Market scenario.

Conservatives would argue that in most cases the best option is no or little regulation. But over the past 20 years, many costly regulations have been promulgated. Many have argued that these promulgations have occurred both under the pro-regulatory Clinton administration and the ostensibly anti-regulatory George W. Bush administration. This point of view, if true, would argue that presidents are largely accountable to the

general electorate and use executive review to ensure that agencies are as well. In this view, both the Clinton and Bush administrations have used executive review to ensure widespread public support for agency regulatory actions rather than actions that maximize net benefits or actions favored by extreme interest groups.

Supporters of regulation would likely argue that in most cases, the greatest (though difficult to measure) benefits are achieved when the level of regulation is high. They would also argue that only under the Clinton administration has such a level of regulation been achieved. This would be consistent with a view of presidential accountability to interest groups. Executive review leads to regulations preferred by interest groups supporting the administration. According to this view, the Clinton administration followed the views of pro-regulation groups and the Reagan and two Bush administrations promulgated regulations favored by anti-regulatory groups.

Either of these views is consistent with the observed data that regulatory options only sporadically correspond with the options that would be chosen by policy officials employing a strict cost-benefit test. The requirement that agencies conduct cost-benefit analysis has not led to the outcomes hoped for by its supporters or feared by its opponents. The chief reason is that, in the federal government over the past two decades, analysis has played a subordinate role to executive review. Elena Kagan argues persuasively that executive review leads to greater accountability and efficiency in the bureaucracy. One side effect of this benefit, however, is that the substantive results of policy may or may not pass cost-benefit tests. Not passing a cost-benefit test is more likely when the same office is charged with both overseeing analytical requirements and assisting the president in exercising oversight.

IMPLICATIONS

What does this analysis imply for regulatory reforms such as those proposed by Hahn and Layburn? The first two of their proposals involve submission by agencies of an enhanced regulatory scorecard to OIRA and expansion of OIRA's authority to oversee independent agencies. If OIRA is indeed forced to place its role as the eyes and ears of the president above its analytical mission, then expanding OIRA's authority is more likely to increase presidential influence than to improve the economic quality of agency regulations.

On issues of low political salience, standardized information such as that which would be contained in a regulatory scorecard may make a marginal difference in OIRA's ability to enforce a net-benefit requirement. On these low salience issues, however, OIRA may already be able to ensure that economics plays an important role in policymaking. On high salience issues, the agency's regulatory scorecard is likely to take a backseat to political concerns. More lonely numbers, indeed.

Questions of politics are likely to render Hahn and Layburn's proposal regarding oversight of independent agencies moot as well. Congressional action would almost certainly be necessary in order to require independent agencies to subject their regulatory actions to OIRA oversight. While Congress may be interested in seeing independent agency rules become

more cost-effective, the argument presented above shows that the primary effect of OIRA oversight would be to give the president more control over independent agency policymaking. Congress, which creates independent agencies in order to protect them from presidential oversight, would be unlikely to give up such powers to its rival branch.

The proposal for a congressional oversight office is more complicated. Niskanen argues logically that such an office would be just as influenced by politics as OIRA is. But congressional politics is different than executive politics. Rather than a unitary policymaker, congressional offices are responsible to 535 disparate ones. The stubborn independence of the Congressional Budget Office, which recently refused to change its assumptions regarding tax cuts and budget deficits, is evidence of an agency that maintains some independence from its putative masters. The Government Accountability Office and Congressional Research Services are also famously independent agencies. A congressional office is more likely (but admittedly not certain) to be free of political influence and would allow for an increased role for economic analysis in executive branch policymaking. **R**

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